

**Memorandum**

NOV 16 1999

Date *Michael Mangano*  
From June Gibbs Brown  
Inspector General

Subject Audit of Administrative Costs - Part A and Part B of the Medicare Program - Blue Cross  
Blue Shield of Texas (A-06-99-00006)

To  
Nancy-Ann Min DeParle  
Administrator  
Health Care Financing Administration

This memorandum is to alert you to the issuance on Thursday, November 18, 1999, of our final report. A copy is attached.

This report presents the results of the certified public accounting firm's, O'Neal Saul, L.L.C., audit of costs claimed on Blue Cross Blue Shield of Texas' (Blue Cross) Final Administrative Costs Proposals for Part A and Part B of the Medicare program for the period October 1, 1994 through September 30, 1998. The review was completed under a contract with the Department of Health and Human Services, Office of Inspector General (OIG). The OIG exercised technical oversight and quality control of the examination. In our oversight, we found nothing to indicate that O'Neal Saul's work was inappropriate or that the report cannot be relied upon.

We are recommending a financial adjustment of \$1,615,063 because Blue Cross:

- claimed \$626,981 of unallowable executive compensation that exceeded the Employment Cost Index (ECI).
- claimed \$543,715 of unallowable professional and consulting costs. These costs were merger and lobbying costs not allocable to Medicare.
- incorrectly allocated \$103,044 of non-Medicare compensation and fringe benefits to the Medicare program.
- allocated \$182,471 of miscellaneous expenses that were related to a merger. These types of expenses are unallowable Medicare expenses.
- did not credit the Medicare program with \$68,059 of complementary insurance credits.

- duplicated \$58,576 of EDP subcontractor charges.
- claimed \$32,217 in unallowable dues to the Blue Cross Association.

In its response, Blue Cross disagreed with the strict use of the ECI used to calculate the excess executive compensation and disagreed with the recommended financial adjustment. Blue Cross also claimed that disallowed costs totaling \$88,330 had not been charged to the Medicare program and disagreed with the recommended financial adjustment. Blue Cross agreed with the remaining audit adjustments.

For further information, contact:

Donald L. Dille  
Regional Inspector General  
for Audit Services, Region VI  
(214) 767-8414

Attachment

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF ADMINISTRATIVE COSTS -  
PART A AND PART B OF  
THE MEDICARE PROGRAM -  
BLUE CROSS BLUE SHIELD OF TEXAS**



**JUNE GIBBS BROWN**  
**Inspector General**

**NOVEMBER 1999**  
**A-06-99-00006**



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Office of Audit Services  
1100 Commerce, Room 6B6  
Dallas, TX 75242

CIN A-06-99-00006

Mr. John W. Howard  
Director  
Blue Cross Blue Shield of Texas  
901 South Central Expressway  
Richardson, Texas 75080

Dear Mr. Howard:

Enclosed is the report covering the audit of administrative costs incurred under the Medicare program by Blue Cross Blue Shield of Texas for the period October 1, 1994 through September 30, 1998. The audit was performed by O'Neal Saul, L.L.C., Certified Public Accountants, at the request of the Department of Health and Human Services (HHS), Office of the Inspector General (OIG), Office of Audit Services, under contract number HHS-100-95-0031. The audit was conducted in accordance with the "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," 1994 revision (GAO Standards).

Your attention is invited to the audit findings and recommendations on pages 3 through 13 of the report, which are summarized in Attachment A to our letter.

The below named Health Care Financing Administration (HCFA) official will be communicating with you in the near future regarding implementation of the recommendations. Should you have any questions or comments concerning these recommendations, please submit them to HCFA no later than 30 days from the date of this letter. If no comments are received by this date, HCFA will proceed with the initiation of the closing agreement. Your comments should be sent to:

Regional Administrator  
Health Care Financing Administration  
1301 Young Street, Room 714  
Dallas, Texas 75202

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), the OIG Office of Audit Services' reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent

Page 2 - Mr. John W. Howard

information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See section 5.71 of the Department's Public Information Regulation, dated August 1974, as revised.)

To facilitate identification, please refer to the above Common Identification Number A-06-99-00006 in all correspondence relating to this report.

Sincerely,

A handwritten signature in dark ink, appearing to read "Donald L. Dille". The signature is fluid and cursive, with the first name "Donald" and last name "Dille" clearly distinguishable.

Donald L. Dille  
Regional Inspector General  
for Audit Services

Enclosures

cc (without enclosure):  
O'Neal Saul, L.L.C.  
Certified Public Accountants  
9755 Dogwood Road, Suite 220  
Roswell, Georgia 30075

HHS Action Official:

James Randolph Farris, M.D.  
Regional Administrator  
Health Care Financing Administration  
1301 Young Street, Room 714  
Dallas, Texas 75202-4348

Summary of Recommendations

<u>Recommendation Codes</u>	<u>Page</u>	<u>Amount</u>	<u>Resolution Agency</u>	<u>Recommendations</u>
01601001021	4	\$626,981	HHS/HCFA	Reduce the FACP's for excessive executive salaries in the amount of \$626,981.
01690810021	4	N/A	HHS/HCFA	Establish procedures to ensure that executive compensation that exceeds the ECI not be allocated to the Medicare program.
01700901021	7	\$543,715	HHS/HCFA	Reduce the FACP's in the amount of \$543,715 for unallowable costs for professional and consulting services.
29992610021	7	N/A	HHS/HCFA	Strengthen internal controls to assure that costs are allocated to the lines of business that they relate and unallowable costs are not allocated to the Medicare program.
02400901021	8	\$103,044	HHS/HCFA	Reduce the FACP's in the amount of \$103,044 for unallowable severance and non-qualified pension plan costs.
29991910021	8	N/A	HHS/HCFA	Establish internal controls to ensure that severance and non-qualified pension payout costs for non-Medicare personnel are not charged to the Medicare program.
03800901021	11	\$182,471	HHS/HCFA	Reduce the FACP's in the amount of \$182,471 for costs that are not allowable under the Federal Acquisition Regulations.
29992610022	11	N/A	HHS/HCFA	Strengthen internal controls to ensure that costs claimed are allowable under the Federal Acquisition Regulations.

Summary of Recommendations

<u>Recommendation Codes</u>	<u>Page</u>	<u>Amount</u>	<u>Resolution Agency</u>	<u>Recommendations</u>
03434201021	12	\$ 68,059	HHS/HCFA	Reduce FACPs in the amount of \$68,059 for complementary insurance credits.
29992610023	12	N/A	HHS/HCFA	Strengthen internal controls to ensure that complementary insurance credit procedures are in accordance with HCFA requirements.
20992201021	13	\$ 58,576	HHS/HCFA	Reduce FACPs in the amount of \$58,576 for duplicate charges to the Medicare program.
29992610024	13	N/A	HHS/HCFA	Strengthen internal controls to ensure that duplicate charges do not go undetected.
04091601021	13	\$ 32,217	HHS/HCFA	Reduce FACPs in the amount of \$32,217 for excessive BCA dues.
29992610025	13	N/A	HHS/HCFA	Establish procedures to ensure that BCA dues that are allocated to Medicare based on amounts allowable per HCFA directives.

**Report on the Audit of  
Administrative Costs Incurred  
Under Part A and B of the  
Medicare Program**

**Blue Cross and Blue Shield of Texas, Inc.  
Richardson, Texas**

**For the Period October 1, 1994 through September 30, 1998**



## **EXECUTIVE SUMMARY**

### **Background**

The Health Care Financing Administration (HCFA) administers the Medicare Program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. HCFA has contracted with Blue Cross Blue Shield of Texas (BCBST) to process Part A claims submitted by certain hospitals and other medical suppliers in approximately 95% of the states including Puerto Rico as well as some foreign claims. During the period of October 1, 1994 through September 30, 1998, BCBST claimed administrative costs of \$68,960,958 to process 26,529,706 Part A Claims.

BCBST also was contracted to process Part B claims submitted by physicians and other medical suppliers in the states of Texas, Maryland, Delaware and the District of Columbia. During the period of October 1, 1994 through September 30, 1998, BCBST claimed administrative costs of \$243,470,479 to process 179,229,393 Part B claims.

### **Objectives**

The objectives of our audit is to determine (1) whether BCBST has established effective systems of internal control, accounting and reporting for administrative costs and (2) whether the Final Administrative Cost Proposals (FACP) presents fairly the costs of program administration allowable in accordance with Part 31 of the Federal Acquisition Regulations.

### **Results of Review**

We found that BCBST has generally established adequate systems of internal control, accounting, and reporting for administrative costs. Further, most of the administrative costs claimed for the period of October 1, 1994 through September 30, 1998 were allowable under the provisions of the contract with HCFA and applicable parts of the Federal Acquisition Regulations. However, we identified \$1,615,063 (\$476,634 - Part A and \$1,138,429 - Part B) which consist of unallowable charges to the Medicare program on the FACP for the period under audit. The issues related to these unallowable costs and adjustments are briefly summarized below and reported in more detail in the "Findings and Recommendations" section of the report.

- BCBST claimed \$626,981 of unallowable executive compensation that exceeded the Employment Cost Index (ECI).
- BCBST claimed \$543,715 of unallowable Professional and Consulting costs. These costs were merger and lobbying costs not allowed by FAR as well as costs not allocable to Medicare.
- BCBST incorrectly allocated Non- Medicare Other Compensation and Fringe Benefits to the Medicare program. This resulted in a \$103,044 overstatement of costs.

- \$182,471 of Miscellaneous Expenses related to a merger which is unallowable by FAR as well as costs incorrectly allocated to the Medicare program.
- BCBST failed to credit Medicare with \$68,059 of Complementary Insurance Credits
- Duplicate EDP subcontractor charges of \$58,576 were claimed by BCBST.
- BCBST claimed \$32,217 of unallowable dues to the Blue Cross Association.

We evaluated BCBST's system of significant internal accounting and administrative controls, and compliance with laws and regulations that can materially affect BCBST's financial statements. Based on our evaluation, except as indicated in the above recommended adjustments, we believe control procedures were adequate for the Department of Health and Human Services' (HHS) purposes, and that BCBST complied with the terms and provisions of laws and regulations for the transactions tested. O'Neal Saul L.L.C. reports on the review of internal control and on compliance appear on pages 17 and 19 respectively.

We expressed an unqualified opinion on the FACPs. Costs recommended for adjustment appear on pages 3 through 14. The opinion of O'Neal Saul L.L.C. appears on page 16 of this report. Prior HHS report findings were reviewed for applicability to the current report.

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## **INTRODUCTION**

### **Background**

Title XVIII of the Social Security Act establishes the Health Insurance for the Aged and Disabled (Medicare) program. This program provides for hospital insurance and related medical insurance for (a) eligible persons 65 and over, (b) disabled persons under 65 who have been entitled to Social Security benefits for at least 24 consecutive months and (c) individuals under age 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

Specifically, Part A of the program is the hospital insurance program and provides coverage related to the cost of inpatient hospital care, post-hospital extended care and post-hospital home health care. Part B of the program is the voluntary medical insurance program and provides protection against the cost of physician services, hospital outpatient services, home health care and other health services.

The Health Care Financing Administration (HCFA) administers the Medicare program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. Contractors administering the Part A provisions of the program are known as Intermediaries and those administering the Part B provisions are known as Carriers. The contracts define the functions to be performed by the Intermediaries and Carriers and provide for the reimbursement of allowable administrative costs incurred in their performance. Such costs are claimed for reimbursement through submission of Final Administrative Cost Proposals (FACP) to HCFA.

HCFA has contracted with Blue Cross and Blue Shield of Texas, Inc. to process Part A claims submitted by certain hospitals and other medical suppliers in approximately 95% of the states including Puerto Rico as well as some foreign claims. In addition to the Medicare Home Office Administration, BCBST has established Part A field offices to assist in processing claims submitted for payment. During the period October 1, 1994 through September 30, 1998, BCBST claimed for reimbursement, administrative costs of \$68,960,958 to process 26,529,706 Part A claims.

BCBST also has been contracted to process Part B claims submitted by physicians and other medical suppliers in the states of Texas, Maryland, Delaware and the District of Columbia. BCBST established Part B field offices to assist in processing claims submitted for payment. During the period October 1, 1994 through September 30, 1998, BCBST claimed for reimbursement, administrative costs of \$243,470,479 to process 179,229,393 Part B claims.

### **Objectives**

The objectives of our audit were to determine whether the contractor (1) established an effective system of internal control and accounting and reporting for administrative costs incurred under the program and (2) presented fairly in the Final Administrative Cost Proposals, the costs of program administration allowable in accordance with Part 31 of the Federal Acquisition Regulation for the period October 1, 1994 through September 30, 1998.

## **Scope**

Our audit was conducted in accordance with generally accepted government auditing standards. The audit objective was to determine whether Medicare Parts A & B administrative costs claimed by BCBST on its Final Administrative Cost Proposals were reasonable, allocable, and allowable.

We examined the administrative costs claimed by BCBST to the extent we considered necessary to determine if amounts claimed were in accordance with applicable Federal requirements, policies and program instructions. Our examination included audit procedures designed to achieve our objective and included a review of accounting records and supporting documentation. The examination included the application of Internal Instruction E-1 revised, Part I dated July 1, 1985 "Review of Administration Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act." The audit excluded a review of the pension costs claimed by BCBST as part of fringe benefits. These costs were reviewed by personnel from the Office of Inspector General, Office of Audit Services as part of a nationwide review of Medicare pension costs.

Audit fieldwork was performed at BCBST in Richardson, Texas during the period December, 1998 through April, 1999.

## FINDINGS AND RECOMMENDATIONS

### EXECUTIVE COMPENSATION

BCBST claimed \$626,981 of executive salaries related to quarterly increases that were not reasonable as compared to the Employment Cost Index (ECI).

The ECI is a quarterly measure established by the Bureau of Labor Statistics of the rate of change in compensation and includes wages, salaries and employers cost of employee benefits. The ECI represents dozens of indices that are calculated for various occupational and industry groups to measure the rate of change in employee compensation. It is a fixed weight index at the occupational level and eliminates the effects of employment shifts among occupations. The ECI is distinguished from other surveys in that it covers all establishments and occupations in the both the private non-farm sector and public sectors. The ECI disclosed the following quarterly increases for the fiscal years under audit:

<u>Year</u>	<u>Qtr 1</u>	<u>Qtr 2</u>	<u>Qtr 3</u>	<u>Qtr 4</u>
1994				0.3%
1995	1.1%	1.3%	0.7%	0.3%
1996	1.1%	1.4%	0.3%	<0.6%>
1997	2.1%	0.6%	0.9%	3.1%
1998	1.6%	1.2%	1.9%	

Total compensation for twenty BCBST executives significantly exceeded quarterly increases as measured by the ECI. Based upon this determination, these costs are unreasonable and thus, unallowable costs in accordance with the FARs detailed below.

FAR Section 31.201-2 (a) states:

“The factors to be considered in determining whether a cost is allowable include the following: (1) Reasonableness, (2) Allocability...”

FAR Section 31.205-6 states:

“... (a) General. Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance...  
(c) Compensation will be considered reasonable if each of the allowable elements making up the employee’s compensation package is reasonable...”

The costs charged to Medicare were \$626,981 higher than the percentage increases allowed by the ECI.

## **Recommendation**

We recommend that BCBST:

1. Reduce its FACP's for each fiscal year as detailed below:

	<u>Part A</u>	<u>Part B</u>	<u>Part B</u> <u>Maryland</u>	<u>Total</u>
FY 1995	\$ 43,342	\$ 71,850	\$ 17,611	\$ 132,813
FY 1996	29,128	56,986	-	86,114
FY 1997	49,661	108,673	-	158,334
FY 1998	80,868	168,852	-	249,720
	<u>\$ 202,999</u>	<u>\$ 406,371</u>	<u>\$ 17,611</u>	<u>\$ 626,981</u>

2. Establish procedures to ensure that compensation that exceeds the ECI not be allocated to the Medicare program.

## **Blue Cross and Blue Shield of Texas, Inc. Response**

BCBST disagrees with this finding and the strict use of ECI to determine reasonable salary levels. They indicate that the individuals identified had significant increases in their scope of responsibilities with appropriate adjustments to compensation. They further state that the FAR allows reasonable compensation based on practices of other similar firms, industry and geographical area.

## **Auditors' Conclusions**

FAR Section 31.205-6 addresses reasonableness based on compensation practices of similar firms and compensation practices of the geographic labor market and job being evaluated. BCBST has not submitted documentation to support their argument of reasonableness. FAR quoted above states "there is no presumption of reasonableness and upon challenge the contractor must demonstrate the reasonableness of the compensation item in question". Of the twenty employees with unreasonable compensation 76% of the excessive amounts were attributable to five employees with two employees accounting for 49%. Documentation to support BCBST contention that there was a significant increase in the scope of responsibilities was not provided to us. Based on the lack of support submitted by BCBST our finding and recommendation remains unchanged.

## **PROFESSIONAL AND CONSULTANT SERVICE COSTS**

BCBST claimed \$543,715 in unallowable costs for professional and consulting services. Details of these amounts and reasons for disallowance are detailed below.

### **Non-Medicare Costs**

BCBST routinely contracts with computer programmers and consultants to perform services such as software enhancements and maintenance. BCBST erroneously allocated \$ 293,125 of costs associated with computer programmers and consultants providing services specifically related to private lines of business to Medicare.

The costs are unallowable in accordance with FAR Section 31.202 (a), which states:

“... all costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly, or indirectly...”

This allocation of non-Medicare costs to Medicare resulted in the following overstatements of the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Part B Maryland</u>	<u>Total</u>
FY 1995	\$ 39,851	\$ 127,342	\$ 34,061	\$ 201,254
FY 1997	940	2,601	-	3,541
FY 1998	<u>88,330</u>	<u>-</u>	<u>-</u>	<u>88,330</u>
	<u>\$ 129,121</u>	<u>\$ 129,943</u>	<u>\$ 34,061</u>	<u>\$ 293,125</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST disagrees with this finding as it pertains to the \$88,330 for FY 1998 and states that this amount was not charged to Medicare, but was 100% allocated to a private side business. BCBST concurred with our finding as it pertains to the balance of \$204,795.

#### Auditors' Conclusions

The documentation that was provided by BCBST indicated that this amount was an indirect allocation through line of business (LOB) 99. The report provided indicated that this amount was allocated 100% to LOB 070 which was Medicare A through September, 1998. Management indicated that the LOB numbering system was revised in October, 1998. However, we did not note a reclassification of the \$88,330 thus our finding and recommendation remains unchanged.

#### **Merger Costs**

During fiscal years 1996, 1997 and 1998, BCBST was in the process of facilitating a merger with Blue Cross Blue Shield of Illinois. As a result of the merger, BCBST became involved in legal proceedings. BCBST also obtained public relations services in relation to the merger. BCBST erroneously allocated \$ 183,205 of the legal fees and public relations fees that were directly related to the merger to Medicare.

These fees directly related to the merger are unallowable in accordance with FAR Section 31.205-27, which states:

“... Except as provided in paragraph (b) of this section, expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions...are unallowable...”



These costs allocated to Medicare that were directly related to the merger resulted in the following overstatement of the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1996	\$ 11,315	\$ 30,132	\$ 41,447
FY 1997	20,690	65,554	86,244
FY 1998	<u>13,307</u>	<u>42,207</u>	<u>55,514</u>
	<u>\$ 45,312</u>	<u>\$ 137,893</u>	<u>\$ 183,205</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

#### Auditors' Conclusion

Our finding and recommendation remains unchanged.

#### **Unsupported Costs**

Expenses of \$ 59,938 for legal, public relation and computer consulting/programming services were not adequately supported to demonstrate that the costs were incurred or allocable to Medicare.

These professional and consulting fees are unallowable in accordance with FAR Section 31.201-2 (d), which states:

“... a contractor is responsible for accounting for costs appropriately and for maintaining record, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract...the contracting officer may disallow or part of a claimed cost which is inadequately supported...”

The failure to provide adequate supporting documentation for costs charged to Medicare resulted in the following overstatements to the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Part B Maryland</u>	<u>Total</u>
FY 1995	\$ 8,850	\$ 33,662	\$ 1,715	\$ 44,227
FY 1996	3,995	11,193	-	15,188
FY 1997	<u>117</u>	<u>406</u>	<u>-</u>	<u>523</u>
	<u>\$ 12,962</u>	<u>\$ 45,261</u>	<u>\$ 1,715</u>	<u>\$ 59,938</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST provided supporting documentation for \$2,464 of Part A and \$6,257 of Part B costs which were unsupported during the audit.

### Auditors' conclusion

Based on a review of the supporting documentation \$2,464 of Part A costs and \$6,257 of Part B costs should be allowed and we have made the appropriate adjustments in this final report. The remaining unsupported costs of \$59,938 remain disallowed.

### **Lobbying and Political Activity Costs**

BCBST claimed \$7,447 in unallowable lobbying costs during fiscal year 1997. Apparently due to a clerical error, BCBST failed to exclude the cost of lobbying and legislative activities from its allocations to Medicare.

The costs are unallowable in accordance with FAR Section 31.205-22 (a), which states:

“...costs associated with the following activities are unallowable...legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation...”

The inclusion of these costs in BCBST's allocation to Medicare resulted in the following overstatement to the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1997	\$ <u>1,749</u>	\$ <u>5,698</u>	\$ <u>7,447</u>

### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

### Auditors' Conclusion

Our finding and recommendation remains unchanged.

### Recommendation

We recommend that BCBST:

1. Reduce its FACPs for each fiscal year as detailed below:

	<u>Part A</u>	<u>Part B</u>	<u>Part B Maryland</u>	<u>Total</u>
FY 1995	\$ 48,701	\$ 161,004	\$ 35,776	\$ 245,481
FY 1996	15,310	41,325	-	56,635
FY 1997	23,496	74,259	-	97,755
FY 1998	<u>101,637</u>	<u>42,207</u>	<u>-</u>	<u>143,844</u>
	\$ <u>189,144</u>	\$ <u>318,795</u>	\$ <u>35,776</u>	\$ <u>543,715</u>

2. Strengthen its internal control procedures to assure that (a) direct costs are allocated to the line of businesses that they relate to and (b) unallowable costs, as specified by regulations, are not allocated to Medicare.

## **OTHER COMPENSATION AND FRINGE BENEFITS COSTS**

BCBST's policy is to record all severance and non-qualified pension plan payouts in a separate cost center and then to manually allocate the costs to the respective cost centers based upon the employees duties. While reviewing these severance and non-qualified pension plan payouts, it was determined that BCBST erroneously allocated \$ 103,044 of these benefits for several personnel not related to Medicare, to the Medicare lines of business. Since these costs are directly related to BCBST's private lines of business, they are unallowable in accordance with FAR Section 31.202 (a) which states:

“...all costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly...”

### **Recommendation**

We recommend that BCBST:

1. Reduce its FACPs for each fiscal year as detailed below:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1996	\$ 2,858	\$ 9,673	\$ 12,531
FY 1997	2,357	13,677	16,034
FY 1998	<u>15,298</u>	<u>59,181</u>	<u>74,479</u>
	<u>\$ 20,513</u>	<u>\$ 82,531</u>	<u>\$ 103,044</u>

2. Establish internal control procedures to ensure that severance and non-qualified pension payout costs related to non-Medicare personnel are not charged directly or indirectly to the Medicare program.

### **Blue Cross and Blue Shield of Texas, Inc. Response**

BCBST accepted this finding and recommendation.

### **Auditors' Conclusion**

Our finding and recommendation remains unchanged.

## **MISCELLANEOUS CLAIMED EXPENSES**

BCBST claimed \$182,471 in unallowable miscellaneous expenses. Details of these amounts and reasons for disallowance are detailed below.

### **Merger Costs**

BCBST claimed \$157,988 in costs related to a merger. These costs were other than public relations costs and legal fees.

As detailed in the Professional and Consultant Services Costs finding, BCBST has been involved in a merger during the fiscal years under audit. Costs related to the merger are unallowable per FAR Section 31.205-27. BCBST created several specific cost centers to capture the costs associated with the merger in order to prevent allocation to Medicare. However, the Medicare line of business was erroneously included in the allocation percentages for these merger related cost centers. This erroneous allocation resulted in these unallowable costs to be allocated to Medicare and resulted in the following overstatement of the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1996	\$ 10,527	\$ 28,443	\$ 38,970
FY 1997	30,552	83,719	114,271
FY 1998	<u>1,763</u>	<u>2,984</u>	<u>4,747</u>
	<u>\$ 42,842</u>	<u>\$ 115,146</u>	<u>\$ 157,988</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

#### Auditors' Conclusion

Our finding and recommendation remains unchanged.

#### **Unsupported Costs**

BCBST allocated \$11,222 of travel expense, Blue Cross Blue Shield conferences and conventions expense, seminar, training and sundry expenses which BCBST did not have supporting documentation that was adequate to demonstrate that the costs were incurred or allocable to Medicare.

These miscellaneous claimed expenses are unallowable in accordance with FAR Section 31.201-2 (d) which states:

“... a contractor is responsible for accounting for costs appropriately and for maintaining record, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract...the contracting officer may disallow or part of a claimed cost which is inadequately supported...”

The failure to provide adequate supporting documentation for costs charged to Medicare resulted in the following overstatements to the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1995	\$ -	\$ 10,490	\$ 10,490
FY 1997	<u>184</u>	<u>548</u>	<u>732</u>
	<u>\$ 184</u>	<u>\$ 11,038</u>	<u>\$ 11,222</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST provided supporting documentation for \$1,218 of Part A and \$7,518 of Part B costs which were unsupported during the audit.

### Auditors' Conclusions

Based on a review of the supporting documentation \$1,218 of Part A and \$7,518 of Part B costs should be allowed and we have made the appropriate adjustments in this final report. The remaining unsupported costs of \$11,222 remain disallowed.

### **Non-Medicare Costs**

BCBST erroneously allocated \$ 8,654 of costs related to its private lines of business to Medicare. BCBST incurred various costs for travel expenses, technical and actuarial services and managed care related costs that were specifically related to private lines of business.

These miscellaneous claimed expenses are unallowable in accordance with FAR Section 31.202 (a) which states:

“... all costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly...”

This allocation of private line costs to Medicare resulted in the following overstatements of the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Part B Maryland</u>	<u>Total</u>
FY 1995	\$ 1,759	\$ 5,889	\$ 512	\$ 8,160
FY 1996	<u>113</u>	<u>381</u>	<u>-</u>	<u>494</u>
	<u>\$ 1,872</u>	<u>\$ 6,270</u>	<u>\$ 512</u>	<u>\$ 8,654</u>

### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

### Auditors' Conclusion

Our finding and recommendation remains unchanged.

### **Other Unallowable Costs**

BCBST claimed \$4,607 in unallowable costs incurred for public relation and advertising, alcoholic beverages and entertainment expenses during the fiscal years under audit.

BCBST claimed \$3,988 of costs for various items such as T-shirts, mugs and other sundry items that were purchased for the purpose of promoting BCBST and its programs. These costs are unallowable in accordance with FAR 31 Section 205.1, which states:

“... Public relations means all functions and activities dedicated to (1) Maintaining, protecting and enhancing the image of a concern or its products... (f) Unallowable public relations and advertising costs include the following... (5) Costs of promotional materials, motion pictures, videotapes, brochures, handouts, magazines, and other media that are designed to call favorable attention to the contractor and its activities... costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public...”

BCBST claimed \$165 of costs for entertainment purposes that are unallowable in accordance with FAR Section 31.205.14, which states:

“... Costs of amusement, diversions, social activities, and any directly associated costs... are unallowable... Costs of membership in social, dining, or country clubs or other organizations having the same purposes are also unallowable...”

BCBST claimed \$454 of unallowable costs for the purchase of alcoholic beverages. These costs are unallowable in accordance with FAR Section 31.205.51, which states:

“... Costs of alcoholic beverages are unallowable...”

These unallowable miscellaneous costs resulted in the following overstatement of the FACPs:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1995	\$ 209	\$ 739	\$ 948
FY 1996	428	1,235	1,663
FY 1997	32	96	128
FY 1998	<u>408</u>	<u>1,460</u>	<u>1,868</u>
	<u>\$ 1,077</u>	<u>\$ 3,530</u>	<u>\$ 4,607</u>

#### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

#### Auditors' Conclusion

Our finding and recommendation remains unchanged.

#### Recommendations

We recommend that BCBST:

1. Reduce it FACPs for each fiscal year as detailed below

	<u>Part A</u>	<u>Part B</u>	<u>Part B Maryland</u>	<u>Total</u>
FY 1995	\$ 1,968	\$ 17,118	\$ 512	\$ 19,598
FY 1996	11,068	30,059	-	41,127
FY 1997	30,768	84,363	-	115,131
FY 1998	<u>2,171</u>	<u>4,444</u>	<u>-</u>	<u>6,615</u>
	<u>\$ 45,975</u>	<u>\$ 135,984</u>	<u>\$ 512</u>	<u>\$ 182,471</u>

2. Strengthen internal control procedures to ensure that costs are only claimed that are allowable by Federal Acquisition Regulations.

## COMPLEMENTARY INSURANCE CREDITS

BCBST understated complementary insurance credits by \$68,059. BCBST did not have any supporting documentation for a reversal of an invoice amount for a complementary insurance credit. In addition, no documentation or support was provided for BCBST's calculation of its own complementary credit rate for the audit period prior to the implementation of a standard rate issued by HCFA.

Contractors routinely process requests from entities for Medicare claims information for complementary information purposes. Complementary insurance credits are amounts due the Medicare program caused by charges to entities for fulfilling these information requests. BCBST processed a routine invoice to a contractor in the amount \$9,746 for complementary insurance credits. This amount was properly credited back to Medicare; however, in the same period BCBST recorded a journal entry and removed the credit. BCBST did not provide any explanation or documentation to support the journal entry.

HCFA Program Memorandum AB-95-1 revised Medicare's regulations concerning financial policies relating to the release of Medicare claims information for complementary insurance purposes. The HCFA established standard rates in this memorandum in an attempt to eliminate the wide disparity of existing contractor complementary insurance rates and the unspecified methodology for developing these rates. The memorandum provided that contractors would no longer determine charges based on their own cost allocations. The standard rates developed using the new methodology were to be implemented effective January 1, 1995. BCBST did not implement the standard rate until April 1995; consequently, from January through March, 1995 BCBST understated the complementary insurance credits that were applied to Medicare. BCBST made subsequent corrections for March 1995, but not for the earlier months. Also, during the three months of the audit period not covered by the Memorandum (October – December of 1994), BCBST had calculated a complementary insurance credit rate for their own private line of business that was less than the rate charged to third party companies. BCBST did not provide any documentation for this reduced rate. The net effect of not implementing the standard rate on January 1, 1995, and for the use of a reduced rate for BCBST private line of business resulted in an understatement of complementary insurance credits to Medicare in the amount of \$58,313.

### Recommendation

We recommend that BCBST:

1. Reduce its FACPs as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1995	\$ 8,257	\$ 50,056	\$ 58,313
FY 1996	<u>9,746</u>	<u>-</u>	<u>9,746</u>
	<u>\$ 18,003</u>	<u>\$ 50,056</u>	<u>\$ 68,059</u>

2. Strengthen its internal control procedures to ensure that complimentary insurance credit procedures are in compliance with HCFA requirements.

### Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

### Auditors' Conclusion

Our finding and recommendation remains unchanged.

## **DUPLICATE CHARGES**

BCBST erroneously claimed \$58,576 in a duplicate manual adjustment to the Interim Expenditure Reports (IER) in two separate months in FY 1995. The recording of this duplicate journal entry for EDP subcontractor costs resulted in the following overstatement of the FACPs:

### **Part B**

FY 1995	\$ <u>58,576</u>
---------	------------------

## **Recommendation**

We recommend that BCBST:

1. Reduce its FACPs by the above amount.
2. Strengthen its internal control procedures to ensure that duplicate entries to the IERs do not go undetected.

## **Blue Cross and Blue Shield of Texas, Inc. Response**

BCBST accepted this finding and recommendation.

## **Auditors' Conclusion**

Our finding and recommendation remains unchanged.

## **BLUE CROSS ASSOCIATION DUES**

BCBST is a member of the Blue Cross Association (BCA) and as such, pay dues to the association. HCFA releases a schedule that specifies the maximum amount of BCA dues that can be claimed as allowable costs. Comparison of the total amounts allocated for BCA dues for each of the years under audit to the HCFA allowable amounts per year revealed that BCBST had exceeded the allowable amount by \$32,217, thus overstating the FACPs.

## **Recommendation**

We recommend that BCBST:

1. Reduce its FACPs for each of the fiscal years as detailed below:

### **Part B**

FY 1995	\$ 1,858
FY 1996	39
FY 1998	<u>30,320</u>
	<u>\$ 32,217</u>

2. Establish procedures to ensure that BCA dues are allocated to Medicare based on the total amounts allowable per HCFA directives.



Blue Cross and Blue Shield of Texas, Inc. Response

BCBST accepted this finding and recommendation.

Auditors' Conclusion

Our finding and recommendation remains unchanged.

## **OTHER MATTERS**

### **SIGNIFICANT EDP EXPENDITURES**

There were no significant EDP costs incurred during the audit period for planning, development or modification of the Medicare claims processing system.

### **INTERIM EXPENDITURE REPORTS**

As part of the audit work performed, a review was undertaken to ascertain the accuracy of BCBST's Interim Expenditure Reports (IER). Based upon our limited review, which revealed no obvious indications of weaknesses or deficiencies other than the amounts included in the Findings and Recommendations Section of this report in BCBST's methods or procedures followed in developing the IERs, a reasonable level of confidence can be placed on the data reported in the IERs.

### **COMPLEMENTARY INSURANCE FINANCIAL POLICIES**

As a result of the audit work performed on the complementary insurance credits procedures and methodology, we believe that BCBST has materially complied with the complementary insurance financial policies. Any instances of non-compliance have been reported in the Findings and Recommendations section of this report along with the recommended adjustments.



**O'Neal Saul, L.L.C.**

Certified Public Accountants

## **INDEPENDENT AUDITOR'S REPORT**

We have audited the Final Administrative Cost Proposals of Blue Cross Blue Shield of Texas, Inc. (BCBST) for the period October 1, 1994, through September 30, 1998. These Final Administrative Cost Proposals are the responsibility of BCBST's management. Our responsibility is to express an opinion on these Final Administrative Cost Proposals based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, 1994 revision, published by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Final Administrative Cost Proposals. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Final Administrative Cost Proposals. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Final Administrative Cost Proposals were prepared to present the cost of administration allowable and applicable to Parts A and B of the Health Insurance for the Aged and Disabled Program pursuant to the reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreements. They are not intended to be a complete presentation of BCBST's assets, liabilities, revenue and expenses.

In our opinion, the accompanying Final Administrative Cost Proposals, as adjusted, present fairly, in all material respects, the cost of administration allowable and applicable to Parts A and B of the Health Insurance for the Aged and Disabled Program for the period October 1, 1994, through September 30, 1998, in accordance with the reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreements.

Our examination was made for the purpose of forming an opinion on the Final Administrative Cost Proposals taken as a whole. The information on pages 1 – 15 is presented for the purposes of background and analysis and is not a required part of the Final Administrative Cost Proposals. Such information has been subjected to the auditing procedures applied in our examination of the Final Administrative Cost Proposals and in our opinion, is fairly stated in all material respects in relation to the Final Administrative Cost Proposals taken as a whole.

This report is intended solely for the use described above and should not be used for any other purpose.

*O'Neal Saul, L.L.C.*

O'Neal Saul, L.L.C.

April 15, 1999



**O'Neal Saul, L.L.C.**  
Certified Public Accountants

## **REPORT ON REVIEW OF INTERNAL CONTROL**

We have audited the Final Administrative Cost Proposals of Blue Cross Blue Shield of Texas, Inc. (BCBST) for the period October 1, 1994, through September 30, 1998, and have issued our report thereon dated April 15, 1999.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

In planning and performing our audit of the Final Administrative Cost Proposals of BCBST for the period October 1, 1994, through September 30, 1998, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the Final Administrative Cost Proposals and not to provide assurance on the internal control structure.

The management of BCBST is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structures policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent irregularities in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policy and procedures into the following categories:

- Procedures to assure accurate, current, and complete disclosures of the financial results of the Medicare program in accordance with Federal reporting requirements;
- Records that adequately identify the application of funds;
- Effective control over and accountability for all funds, property, and other assets;
- Comparison of actual with budgeted amounts for each period;
- Procedures for determining the allowability and allocability of costs in accordance with FAR Part 31, and Appendix B and C of the Medicare agreements;
- Accounting records that are supported by source documentation.

For all of the internal control structures categories listed, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control structure that, in our judgment could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the Final Administrative Cost Proposals. All reportable conditions are described in the Findings and Recommendations section of this report on pages.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the Final Administrative Cost Proposals being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

The report is intended for the information of the Department of Health and Human Services and BCBST's management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

*O'Neal Saul, LLC*

O'Neal Saul L.L.C.  
April 15, 1999



**O'Neal Saul, L.L.C.**

Certified Public Accountants

## **REPORT ON COMPLIANCE**

We have audited the Final Administrative Cost Proposals of Blue Cross Blue Shield of Texas, Inc. (BCBST) for the period October 1, 1994, through September 30, 1998, for its Medicare Parts A & B contracts and have issued our report thereon dated April 15, 1999.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

Compliance with laws and regulations applicable to BCBST is the responsibility of BCBST's management. As part of obtaining reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement, we performed tests of BCBST's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Final Administrative Cost Proposals. The results of our test of compliance disclosed the following material instances of non-compliance.

As described in the Findings and Recommendations section of this report, in certain instances BCBST allocated costs to the Final Administrative Cost Proposals that are non-reimbursable according to the Federal Acquisition Regulations.

We considered these material instances of non-compliance in forming our opinion on whether BCBST's Final Administrative Cost Proposals are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated April 15, 1999, on those Final Administrative Cost Proposals.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, BCBST complied, in all material respects, with the provisions referred to in the third paragraph of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that BCBST had not complied, in all material respects, with those provisions.

This report is intended for the information of the Department of Health and Human Services and BCBST's management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

O'Neal Saul, L.L.C.  
April 15, 1999

## APPENDIX

**Exhibit A**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)  
AND THE RECOMMENDED COST ADJUSTMENTS  
FOR THE FISCAL YEARS 1994 THROUGH 1998**

<u><b>OPERATION</b></u>	<u><b>ADMINISTRATIVE COSTS</b></u>
Bills Payment	\$ 28,884,058
Recons & Hearings	1,497,342
Appeals	773,479
Inquiries	2,089,463
Provider Ed. & Training	674,857
Medicare Secondary Payer	4,905,940
Medical & Utilization Review	4,031,721
Provider Desk Reviews	4,682,044
Provider Field Audits	6,204,907
Provider Settlements	6,393,696
Provider Reimbursement	7,108,400
Special Projects	228
Productivity Investment	1,449,110
Benefits Integrity	1,000,934
Credits	(331,840)
Other	78,595
Other	(481,976)
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b>\$ 68,960,958</b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 202,999
2. Professional & Consultant Service Costs	189,144
3. Other Compensation & Fringe Benefits	20,513
4. Miscellaneous Claimed Expenses	45,975
5. Complementary Insurance Credits	18,003
6. Duplicate Costs	-
7. BCA Dues	-
<b>Total Adjustments</b>	<b>476,634</b>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b>\$ 68,484,324</b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.



**Exhibit B**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
FOR THE FISCAL YEARS 1994 THROUGH 1998**

<b><u>OPERATION</u></b>	<b><u>ADMINISTRATIVE COSTS</u></b>
Claims Payment	\$ 134,098,337
Appeals/ Review & Hearings	20,353,281
Inquiries	45,812,447
Provider Ed. & Training	5,817,697
Medical & Utilization Review	9,755,733
Medicare Secondary Payor	5,646,792
Participating Physician	7,580,485
Productivity Investment	7,186,995
Credits	(6,796,108)
Other	(10,968,900)
Benefits Integrity	4,991,873
Other	10,322,987
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 233,801,619</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 406,371
2. Professional & Consultant Service Costs	318,795
3. Other Compensation & Fringe Benefits	82,531
4. Miscellaneous Claimed Expenses	135,984
5. Complementary Insurance Credits	50,056
6. Duplicate Costs	58,576
7. BCA Dues	32,217
Total Adjustments	<u>1,084,530</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 232,717,089</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

Exhibit C

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (MARYLAND PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1998**

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Claims Payment	\$ 5,871,297
Reviews & Hearings	820,779
Bene./ Phys. Inquiry	1,526,022
Provider Education	238,424
Medical & Utilization Review	510,934
Medicare Secondary Payor	321,546
Participating Physician	421,175
Productivity Investment	408,803
Other	(871,680)
Benefits Integrity	421,560
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b>\$ 9,668,860</b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 17,611
2. Professional & Consultant Service Costs	35,776
3. Other Compensation & Fringe Benefits	-
4. Miscellaneous Claimed Expenses	512
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	-
Total Adjustments	53,899
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b>\$ 9,614,961</b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

Exhibit D

**BLUE CROSS BLUF SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995**

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Bills Payment	\$ 5,801,010
Recons & Hearings	329,343
Medicare Secondary Payer	1,370,870
Medical & Utilization Review	1,230,945
Provider Desk Reviews	1,494,200
Provider Field Audits	1,919,900
Provider Settlements	1,302,285
Provider Reimbursement	1,317,100
Productivity Investment	29,000
Benefits Integrity	216,787
Other	58,039
Other	(106,555)
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 14,962,924</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 43,342
2. Professional & Consultant Service Costs	48,701
3. Other Compensation & Fringe Benefits	-
4. Miscellaneous Claimed Expenses	1,968
5. Complementary Insurance Credits	8,257
6. Duplicate Costs	-
7. BCA Dues	-
Total Adjustments	<u>102,268</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 14,860,656</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

**Exhibit E**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995**

<u><b>OPERATION</b></u>	<u><b>ADMINISTRATIVE COSTS</b></u>
Claims Payment	\$ 30,503,996
Reviews & Hearings	4,290,411
Bene./ Phys. Inquiry	6,563,382
Provider Education	1,257,168
Medical & Utilization Review	2,760,220
Medicare Secondary Payor	1,527,750
Participating Physician	2,079,287
Productivity Investment	1,046,226
Other	(3,613,979)
Benefits Integrity	1,313,019
Other	<u>2,081,033</u>
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 49,808,513</u></b>
 <b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 71,860
2. Professional & Consultant Service Costs	161,004
3. Other Compensation & Fringe Benefits	-
4. Miscellaneous Claimed Expenses	17,118
5. Complementary Insurance Credits	50,056
6. Duplicate Costs	58,576
7. BCA Dues	<u>1,858</u>
Total Adjustments	<u>360,472</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 49,448,041</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

Exhibit F

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (MARYLAND PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995**

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Claims Payment	\$ 5,871,297
Reviews & Hearings	820,779
Bene./ Phys. Inquiry	1,526,022
Provider Education	238,424
Medical & Utilization Review	510,934
Medicare Secondary Payor	321,546
Participating Physician	421,175
Productivity Investment	408,803
Other	(871,680)
Benefits Integrity	<u>421,560</u>
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 9,668,860</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 17,611
2. Professional & Consultant Service Costs	35,776
3. Other Compensation & Fringe Benefits	-
4. Miscellaneous Claimed Expenses	512
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	<u>-</u>
Total Adjustments	<u>53,899</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 9,614,961</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

**Exhibit G**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1995 THROUGH SEPTEMBER 30, 1996**

<b><u>OPERATION</u></b>	<b><u>ADMINISTRATIVE COSTS</u></b>
Bills Payment	\$ 8,228,817
Recons & Hearings	480,832
Medicare Secondary Payer	1,911,344
Medical & Utilization Review	1,431,128
Provider Desk Reviews	1,642,918
Provider Field Audits	2,207,015
Provider Settlements	2,727,898
Provider Reimbursement	1,951,684
Productivity Investment	656,419
Benefits Integrity	353,452
Other	850
Other	(124,316)
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 21,468,041</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 29,128
2. Professional & Consultant Service Costs	15,310
3. Other Compensation & Fringe Benefits	2,858
4. Miscellaneous Claimed Expenses	11,068
5. Complementary Insurance Credits	9,746
6. Duplicate Costs	-
7. BCA Dues	-
Total Adjustments	<u>68,110</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 21,399,931</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

Exhibit H

BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1995 THROUGH SEPTEMBER 30, 1996

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Claims Payment	\$ 35,167,972
Reviews & Hearings	4,796,595
Bene./ Phys. Inquiry	8,822,076
Provider Education	1,632,664
Medical & Utilization Review	3,311,064
Medicare Secondary Payor	2,291,415
Participating Physician	2,325,692
Productivity Investment	2,445,242
Other	(7,068,973)
Benefits Integrity	1,581,369
Other	6,576,715
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 61,881,831</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 56,986
2. Professional & Consultant Service Costs	41,325
3. Other Compensation & Fringe Benefits	9,673
4. Miscellaneous Claimed Expenses	30,059
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	39
Total Adjustments	<u>138,082</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 61,743,749</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

**Exhibit I**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1996 THROUGH SEPTEMBER 30, 1997**

<b><u>OPERATION</u></b>	<b><u>ADMINISTRATIVE COSTS</u></b>
Bills Payment	\$ 9,562,792
Recons & Hearings	687,167
Medicare Secondary Payer	1,623,726
Medical & Utilization Review	1,369,648
Provider Desk Reviews	1,544,926
Provider Field Audits	2,077,992
Provider Settlements	2,363,513
Provider Reimbursement	1,823,404
Productivity Investment	456,400
Benefits Integrity	430,695
Other	19,706
Other	(251,105)
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 21,708,864</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 49,661
2. Professional & Consultant Service Costs	23,496
3. Other Compensation & Fringe Benefits	2,357
4. Miscellaneous Claimed Expenses	30,768
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	-
Total Adjustments	<u>106,282</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 21,602,582</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.



Exhibit J

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1996 THROUGH SEPTEMBER 30, 1997**

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Claims Payment	\$ 35,706,536
Reviews & Hearings	7,002,801
Bene./ Phys. Inquiry	11,022,946
Provider Education	1,330,234
Medical & Utilization Review	3,684,449
Medicare Secondary Payor	1,827,627
Participating Physician	2,084,268
Productivity Investment	2,210,641
Other	(285,943)
Benefits Integrity	2,097,485
Other	1,665,239
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 68,346,278</u></b>
<b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 108,673
2. Professional & Consultant Service Costs	74,259
3. Other Compensation & Fringe Benefits	13,677
4. Miscellaneous Claimed Expenses	84,363
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	-
Total Adjustments	<u>280,972</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 68,065,306</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

**Exhibit K**

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1997 THROUGH SEPTEMBER 30, 1998**

<b><u>OPERATION</u></b>	<b><u>ADMINISTRATIVE COSTS</u></b>
Bills Payment	\$ 5,291,439
Appeals	773,479
Inquiries	2,089,463
Provider Ed. & Training	674,857
Provider Reimbursement	2,016,212
Productivity Investment	307,291
Special Projects	228
Credits	<u>(331,840)</u>
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 10,821,129</u></b>
 <b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 80,868
2. Professional & Consultant Service Costs	101,637
3. Other Compensation & Fringe Benefits	15,298
4. Miscellaneous Claimed Expenses	2,171
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	<u>-</u>
Total Adjustments	<u>199,974</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 10,621,155</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

Exhibit L

**BLUE CROSS BLUE SHIELD OF TEXAS  
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)  
AND THE RECOMMENDED COST ADJUSTMENTS  
OCTOBER 1, 1997 THROUGH SEPTEMBER 30, 1998**

<u>OPERATION</u>	<u>ADMINISTRATIVE COSTS</u>
Bills/Claims Payment	\$ 32,719,833
Appeals	4,263,474
Inquiries	19,404,043
Provider Education/ Training	1,597,631
Participating Physician	1,091,238
Productivity Investment	1,484,886
Credits	<u>(6,796,108)</u>
<b>TOTAL ADMINISTRATIVE COSTS CLAIMED</b>	<b><u>\$ 53,764,997</u></b>
 <b>Recommended Adjustments</b>	
1. Executive Compensation	\$ 168,852
2. Professional & Consultant Service Costs	42,207
3. Other Compensation & Fringe Benefits	59,181
4. Miscellaneous Claimed Expenses	4,444
5. Complementary Insurance Credits	-
6. Duplicate Costs	-
7. BCA Dues	<u>30,320</u>
Total Adjustments	<u>305,004</u>
<b>COSTS RECOMMENDED FOR ACCEPTANCE</b>	<b><u>\$ 53,459,993</u></b>

**Note:** Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

## APPENDIX



September 1, 1999

Mr. Charles E. Saul, C.P.A.  
O'Neal Saul, L.L.C.  
9755 Dogwood Road, Suite 200  
Roswell, GA 30075

Dear Mr. Saul:

Below is the Blue Cross and Blue Shield of Texas, Inc., response to the audit for the period October 1, 1994 through September 30, 1998. Also included is a schedule of proposed adjustments to your audit findings.

#### Executive Compensation

BCBSTX disagrees with the auditors finding and the strict use of the Employment Cost Index (ECI) to determine reasonable salary levels.

The use of the ECI assumes that an individuals job function remains static over the time period being reviewed. During this audit period the individuals identified had significant increases in their scope of responsibilities, with appropriate adjustment to compensation.

The BCBSTX salary structure is reviewed and updated annually. Salary levels are set to be competitive within the industry and locations. The FAR does not require that the ECI be the only method of salary determination. FAR 31.205-6 (b) states in part the following:

The compensation for personal services paid or accrued to each employee must be reasonable for the work performed. Compensation will be considered reasonable if each of the allowable elements making up the employee's compensation package is reasonable. In determining the reasonableness of individual elements for particular employees or classes of employees, consideration should be given to all potentially relevant facts. Facts which may be relevant include **general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, the compensation practices of other firms in the same geographic area**, the compensation practices of firms engaged in predominantly non-Government work, and the cost of comparable services obtainable from outside sources.

#### Professional and Consultant Service Costs

BCBSTX disagrees with two findings.

The charges for CSC Healthcare in the amount of \$88,330 was not charged to Medicare, but was 100% allocated to a private side product. This amount should not be disallowed from Medicare B.

The invoice to Haynes and Boone in FY 97 (item 55) was to cover the cost of a Medicare Compliance audit initiated by BCBSTX. This report was sent to Gary Kavanaugh, Director of Medicare Contractor Management Group. The \$2,464 charge to Medicare A and the \$6,257 charge to Medicare B should not be disallowed. Supporting documentation for these two charges is attached.

### **Other Compensation and Fringe Benefits Costs**

BCBSTX does not currently dispute this finding.

### **Miscellaneous Claimed Expense**

The auditors disallowed several invoices which were charged to Medicare but had no supporting documentation. Attached is the documentation for the following items: 2M, 2J, 5S, 1S, 6S, 7S. The documentation supports the charges to Medicare A of \$157 and Medicare B of \$7,518 and these should not be disallowed.

### **Complementary Insurance Credits**

BCBSTX does not currently dispute this finding.

### **Duplicate Charges**

BCBSTX does not currently dispute this finding.

### **Blue Cross Association Dues**

BCBSTX does not currently dispute this finding.

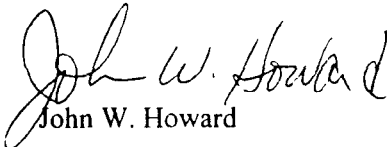
With these adjustments, the findings are:

	<b>Part A</b>	<b>Part B</b>	<b>Total</b>
Draft Report	391,986	1,240,534	1,632,520
Adjustment:			
Executive Comp.	(202,999)	(423,982)	(626,981)
CSC Healthcare		(88,330)	(88,330)
Haynes & Boone	(2,464)	(6,257)	(8,721)
Misc. Expenses	(157)	(7,518)	(7,675)
Net	186,366	714,447	900,813

Note: Exhibits K and L in the draft report are incomplete and include only Program Management costs.

If you have any questions, please do not hesitate to contact me at (972) 766-6193.

Sincerely,



John W. Howard

JWH/seg

Enclosures

c: Denise Bujak, Vice President and Controller  
Marti Mahaffey, Vice President of Medicare Operations